RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

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May 1, 1991 **LETTER 1068**

Apr. 19 DJIA 2965.59; PTI 3255; A-D Ratio -11.03
Apr. 26 DJIA 2912.38; PTI 3253; A-D Ratio -11.62
Dow Yield: 2.47%; Dow P/E: 18.0; DowPow: 0
Dow 200-day MA: 2692; Dow 30-day MA: 2924
Dow Book Value: 1276; PTI 89-day MA: 3192
Percentage of Undervalued Blue-chips: 14%

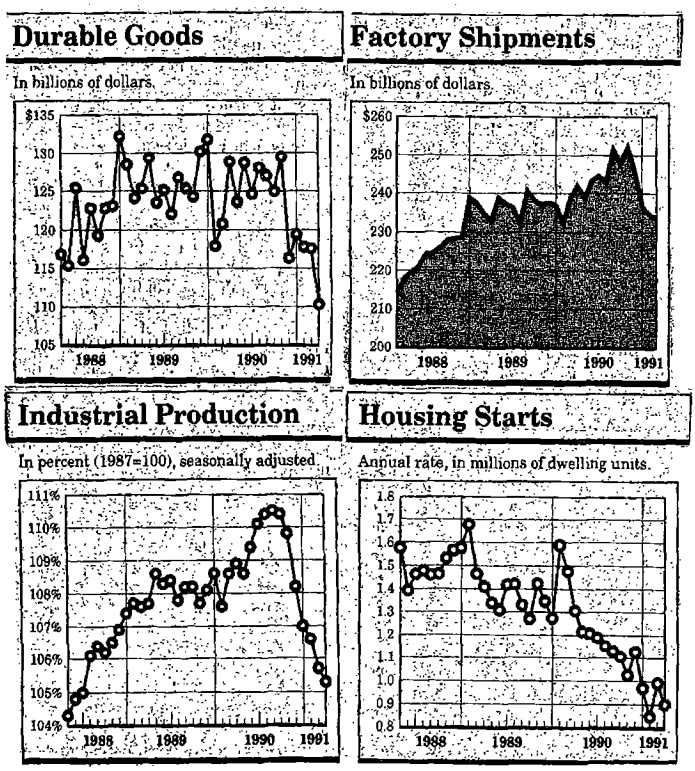
THE MARKET: Wall Street has seldom produced a more powerful drama. These charts (courtesy *Wall Street Journal)* illustrate the recessionary condition of the country today. Yet every market student knows that the market's function is to discount, to look ahead. The market isn't interested in what happened yesterday, nor is it interested in what's happening today. The market's focus is on tomorrow and next week and the next six months.

If that's true, isn't it obvious that the stock market is now predicting much better times for the US economy in months to come? Oh yes, absolutely. "But wait," say the skeptics, "when the market suffered its great crash in October 1987, wasn't that a prediction of a recession that 'should have appeared' in 1988? Yet, the recession never came. Pretty ornery -- and surprising. So couldn't the great stock market surge of 1990 be another surprise, a reverse-image of 1987? Couldn't the 1990 rise be the stock market celebrating a big recovery that doesn't materialize?"

The predictions of a second or third quarter end of the recession are almost unanimous. It's literally "a given." So the question: what if, following the market's big 1990 advance, the current recession refuses to go away? My answer -- if that happens the bear will emerge from his lair.

So much for conjecture and theory. But what's actually happening now. Where are the places that we should be watching?

(1) I'm watching the Dow, which despite new highs for most of the other averages, was only "king for a day." By that I mean that the Dow closed above 3000 for a single trading session -- 3004.46 on April 17.

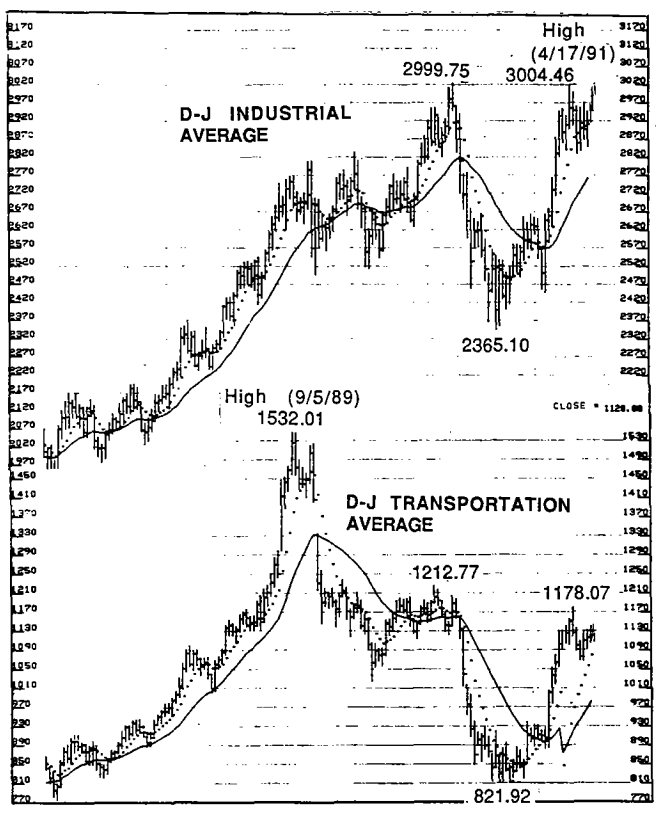


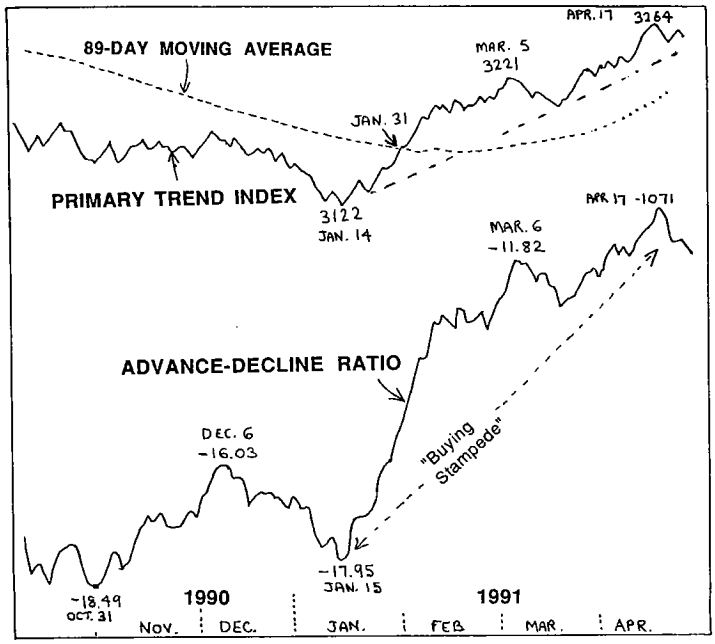
I want to refresh readers on the meaning of the Dow. The D-J Industrial Average is made up of 30 of the most watched and analyzed stocks in the world. For the most part these are huge, investment-grade, blue-chip issues.

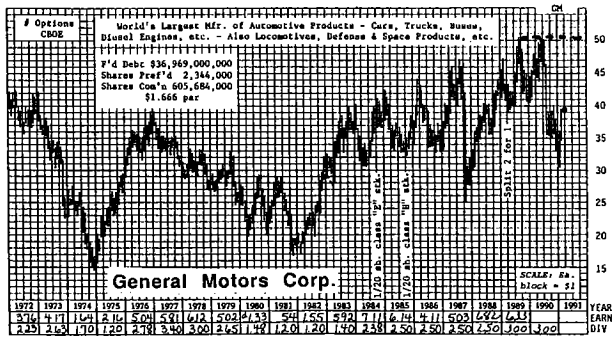
The value of the Dow as an indicator is this: the Dow stocks are the kind that are bought and held by large investors. The buying (and selling) of large investment interests makes the trend. A continuous rise (or fall) in the Dow will always be joined by the rest of the market in due time. Conversely, if the Dow stubbornly refuses to join the rest of the market during an advance or a decline, the trend will halt or reverse.

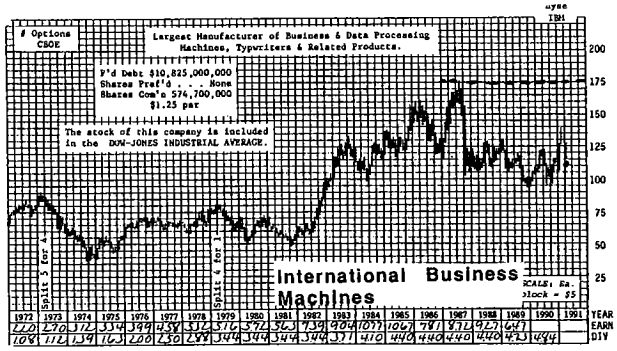
So what happened? The Dow climbed to slightly above 3000, then turned down. I thought that reversal was significant. It meant that at 3000, large investment interests decided that it was time to halt their buying and either stand back or start selling. The question now is -- how much selling will come from large investment interests? We don't know -- yet.

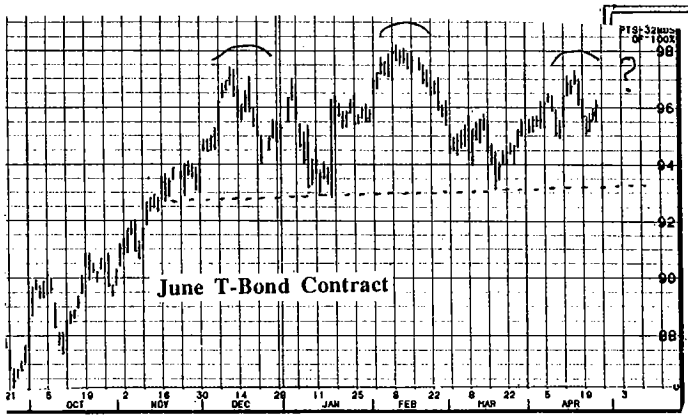
(2) The page 1 weekly chart of the Averages (courtesy of *Mansfield*) shows the long-term relationship between the Dow and the non-confirming Transports. This is a strange picture and one

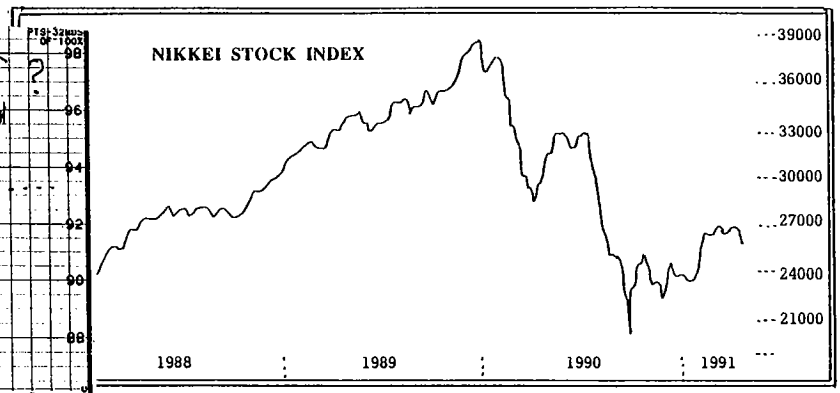


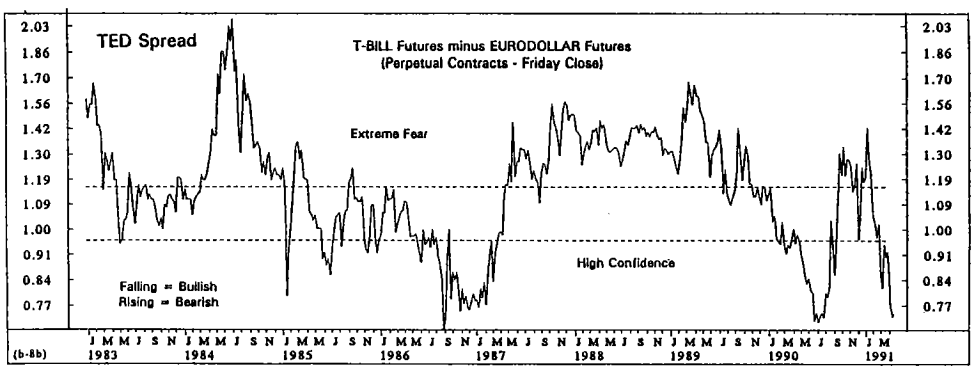


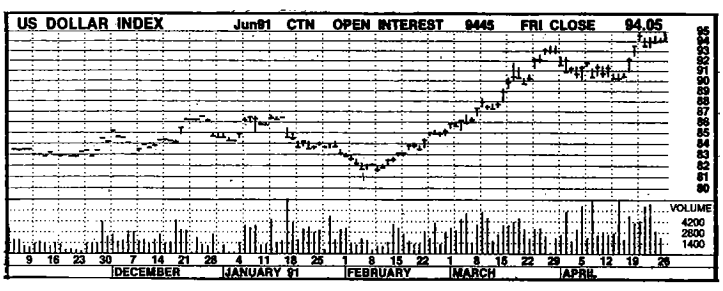

World's Largest Mfr. of Automotive Products - Cars, Trucks, Buses, Diesel Engines, etc. - Also Locomotives, Defense & Space Products, etc.
General Motors Corp.


Largest Manufacturer of Business & Data Processing Machines, Typewriters & Related Products.
The stock of this company is included in the DOW-JONES INDUSTRIAL AVERAGE.
International Business Machines









that hints of danger. It's particularly interesting because even though the Transports are lagging, they are still vastly overpriced on a valuation basis. The current 1.6% yield provided by the Transportation Average is one of its lowest on record.

(3) I said that the "buying stampede" would end when the advance-decline ratio dropped one full point from its highest level. Turn to the page 2 chart. Note that as of this writing, the A-D ratio has still not dropped a full point from its high. Thus, the "buying stampede" is still on (although it's close to ending).

(4) The bond market is at a critical juncture. The Administration is (as usual) putting pressure on the Fed to lower rates even further. But the Fed has indicated that it is satisfied for now. So all eyes are on the bond market. The bonds look toppy and the pattern is of a potential head-and-shoulders top (see chart, page 2). But "potential" is one thing, actual is another. The June contract would have to break below 93 before we could say "Good bye" to the bonds and "Hello" to higher interest rates.

(5) Last week the Utility Average suddenly plunged below the 210 level. The Utility Average tends to act as a leading indicator of interest rates. The Utilities also tend to be a bellwether for the

whole stock market. Either way, the Utilities should be watched carefully now. Surprisingly, the much touted Utilities have been the weakest of the D-J Averages.

(6) Bullishness at the Dow high (in mid-April) rose to extremes, and even now analysts continue to predict "Dow 4000 or 5000" in 1993. One excellent measure of confidence is the Ted Spread. This is the T-bill future contract minus the Eurodollar contract. When investors are confident, they buy the higher yielding but more speculative Euros. When they are worried, they switch to the safety of T-bills.

The long term TED spread chart (courtesy of *Ned Davis Research*) on page 2 shows that the TED spread has sunk to around .65. Considering the plight of the banks and the insurance companies, considering the recession, considering the problems in the Mideast, it seems to me that the TED spread is reflecting an extraordinary amount of confidence -- or should I say super-complacency. So let's watch the TEDs.

(7) The dollar has been a tiger (see page 2 chart). And although a rising dollar is great for US tourists abroad, it's a killer for US firms that export. So everybody's asking, "Why the strong dollar?" And nobody's got the perfect answer. A few answers: the bloom has come off the Deutsche mark, what with the East Germany mess and the neighboring Soviets about to collapse. Japan's economy is slowing a bit. On top of that, the dollar was just plain cheap (purchasing power parity), so all that was needed was a little incentive and the buck was ready to rise. Victory in the Persian Gulf also revived confidence in the US. All of these items have militated toward a stronger dollar, but it's the rapidity of the dollar rise that has surprised almost everyone (Dollar Index courtesy of *Investor's Daily*).

(8) Here's a fascinating item. The Dow's two time-honored bellwether stocks, **IBM** and **GM,** are both acting strangely, or should I say poorly, as the monthly charts on page 2 indicate. GM is still well below both its 1987 and 1989 high. And IBM is far below its 1987 record high. Is this significant -- or is it simply telling us that the two former bellwether stocks are no longer bellwethers? My own opinion is that the weakness in GM and IBM is indicative of the fact that many of America's greatest corporations are now falling behind in the global struggle for market share.

(9) This is a global world, and one spot on the globe that I watch with great interest is Japan's Nikkei Average. Surprisingly, Japan's stock market didn't participate in the 1990 rise with anything like the power of the US rise, and this despite the fact that Japan's stock market has led the Dow on the upside for decades. Furthermore, Japan hasn't had a recession since WWII. Despite a population half as large as the US', Japan's economy is two-thirds as large as ours and growing. The Japanese equate exporting with national survival. Japan reinvests 25% of its industrial profits, the highest reinvestment level of any industrialized nation on earth. Incredibly, Japan puts more money into fixed investments (not including housing) than the US.

In my opinion, Japan wants (economically) to take over the world. And the way Japan is going, it could happen. Japan tried to take over the world via its military in the 1940s but failed. Japan would like to do it economically in the 1990s. So I always keep one eye on the Nikkei. Thus, the big question -- is the lagging Nikkei telling us something about the Japanese economy? Is Japan cooling off, or possibly running into trouble?

BIG PICTURE: Long-term investing is a funny thing. Consider this -- on August 25, 1987, at the Dow high for the year (two months before the crash) the Dow was 2722.42. As this is written, the Dow is in the 2930 area. That represents a gain from the 1987 peak of 208 points. In other words, the Dow is currently about 7.6% above its high of nearly four years ago.

Comparison: The yield on the Dow has averaged less than 4% since 1987, so the surprising conclusion is that if you had simply stayed in Treasury bills over the same period, you'd actually be ahead today. And you would have spared yourself the agony of living through two market crashes and the severe 1990 breadth collapse.

So what does it all mean? To me it certainly suggests that at the 1987 high the Dow was in a top area -- and the collapses and subsequent surges since then have simply been market thrusts into the overvalued zone -- in other words, more top-building.

It reminds me of a bull fight that I saw in Tijuana back in 1963 (yeah, I used to go to the bull fights back then). This particular brave bull received a poorly placed sword thrust. The poor bovine staggered backwards, then dropped. The smiling matador bowed to the grandstands. But suddenly, to the crowds' horror, the bull staggered to his feet and charged the matador. The matador leapt aside, and the bull sank to the arena floor again. This happened three times before the bull finally succumbed to the thrust of the sword.

I get that same feeling as I watch this market. But just what is this market -- is it a bull market, is it the end of a bull market that began in 1974, is it the beginning of a new bull market that started from the October 1990 low, is it part of a bear market's early stirrings, a bear market that started with the 1987 crash? Tough questions, and at this juncture I don't have a definitive answer.

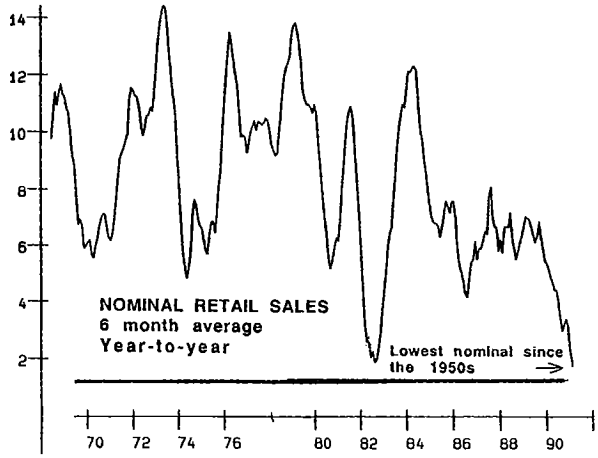
I will say this -- if it's a bull market, it's the one that I like least of any I've seen. I didn't like this market on a value basis back in October or January, I didn't like the two crashes that preceded it, I didn't like the fact that the percentage of undervalued blue chips never got over 35% during the whole period of 1987 to the present (currently, only 14% of the blue chips are undervalued, a dangerously low percentage). And I haven't liked the incredible overvaluation of the Transportation Average with its ridiculous current yield of 1.6%.

Then there are the fundamental problems, or should I call them the structural problems in the economy. Many people believe that the most serious long-term problem we face today is the eroding quality of our education. I do know this -- US corporations are spending tens of millions of dollars teaching their workers to read and write. That isn't necessary in Japan or Germany or Taiwan. A second problem is declining productivity in this country. This is a particularly pressing problem in the current highly competitive global economy. A third problem is the stifling amount of compounding debt that has been built up by the government, by corporations and by American consumers. And a fourth problem is that the US is falling behind Japan in many areas, including some technology and in finance.

Consumer spending accounts for around 70% of our Gross National Product. Now here's the baffling paradox. If the US is to become more solvent and more competitive, it must boost the current rate of savings, which is now a minuscule 4.5% (vs. 13% in Germany and 16-20% in Japan). Today the Administration, the Fed and the Treasury are hell-bent on trying to get the American consumer to spend more, to borrow more, to consume more.

But today the American consumer is strapped with debt and trying to get out from under. Therefore, the economic irony is that if the consumer increases his spending, he'll have to save even less than the current low 4.5%. Conversely, if the consumer increases his saving, he'll have to spend less. High consumption means low savings.

At any rate, this chart by Ed Hyman of *International Strategy and Investments* shows nominal retail sales (year-to-year) dropping to the lowest level since the 1950s. Something is scaring America's consumers, and it's causing them to tighten their belts. What's scaring consumers? Increasing unemployment, a record number of personal bankruptcies, rising taxes, rising cost-of-living and a crushing level of personal debt.



My conclusion: because of the structural problems in the US economy, the path out of this recession is going to be very difficult. As I see it, the recession may ease up a bit, but lower interest rates and a fat level of free reserves at the banks are not going to "automatically" move this nation back to prosperity.

INVESTMENT POSITION: There's a lot of disagreement in this area; you can feel it in the air, you can see it in the market action, you can document it via the heavy insider selling. The stock market's been looking ahead to "better times," at today's fat prices the better times better materialize.

IQ Trends' percentage of bullish blue-chip stocks has dropped to a new low of 14%. This emphasizes the fact that historically, on a valuation basis, this market is in a top area.

The yield on five-year Treasury bonds is 7.7%, not bad, but I feel that this is a time to watch and wait, and preferably in the most liquid condition. I'm happy to be in T-bills and government-only money market funds.

By the way, last week the Treasury hinted that instead of quarterly auctions of 10-year notes, it might move to monthly auctions of the 10-year babies. The total amount of assorted bills, notes and bonds at government auctions keeps increasing right along with the federal deficits. Uncle Sam can change the laws, but there's one law that he can't change -- it's the law of compounding interest.

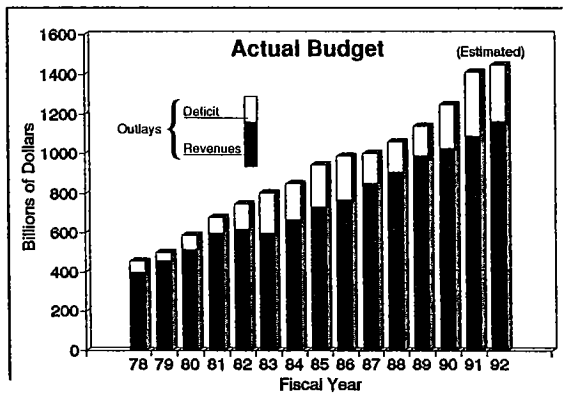
NOTES & QUOTES: As readers know by now, I'm no George Bush fan. I still think Bush is a wimp, and I also think that there's nothing worse than a wimp who will do anything to convince people that he's not one. So the war's over and what have we got. Saddam still in power, a spate of genocide, an ecological disaster in the Mideast, tens of thousands of Kurds starving or dying of disease and dehydration, probably a long-term presence by the US military in the Mideast, Iraq physically destroyed, and Americans wondering what the hell it was all about.

I thought this was an interesting comment from the *Washington Post* : "Hussein's short-term strategy appears clear, Iraqi analysts say. By accepting the UN terms for a permanent cease-fire April 6, he hopes to rid Iraq of foreign intervention, end economic sanctions, and begin rebuilding his damaged power base. By reshuffling his cabinet, making vague promises of multi-party democracy and offering conditional amnesty to his foes, he hopes to lessen popular pressure on his government at home. But few in Iraq view the government's concessions as anything other than window dressing designed to help protect Hussein until he feels strong enough to assert total control. And analysts warn that the myth of Hussein -- his aura as a survivor and his reputation for brutality -- has been *enhanced*."

* *

Here we go again: For the new fiscal year beginning October 1, 1992, the Administration budget calls for spending of $1.452 trillion with a deficit of $290 billion. The House immediately rejected the Bush budget; the House budget calls for spending of $1.459 trillion with a deficit $280 billion. The Bush people estimate that this year's deficit will be $318 billion. For the record: Not once did Reagan or Bush ever present a budget that was balanced.

Here's what the budgets since 1978 look like:



As for the states, 26 states have raised or will raise additional taxes this year of $10.6 billion. For 1992 an additional $6.7 billion in new taxes have already been proposed.

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Does anyone believe the government's statistics on inflation? Does anyone believe that living costs are leveling off? Does anyone ever wonder why TAXES aren't included in the cost-of-living statistics? Last week *Corporate Travel* magazine put out their annual study of business travel and what it costs for a hotel room, a rental car and three meals in various cities. Concluded the magazine's editor, "Even with recession in full swing, companies that pay full price will shell out 8% more this year to send executives on the road." Russell comment: Unless I'm mistaken, that's inflation. Government statisticians, please take note. By the way, the most expensive cities were NYC, Boston, Chicago, LA, Houston, Newark, Phila., Dallas. Cheapest cities were Tallahassee, Biloxi, Jackson, Roanoke, Shrevesport (all in the bargain South).

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Hold it, now that the Reagan s have been examined, cut up and castigated with the whole world wondering how much of the Kelly book is the honest-to-God truth, there's a new Simon and Schuster expose coming out. This one is about the wheeler-dealer-spieler Donald Trump. The book is by Jack O'Donnel, former top Trump exec. It's all about how Trump ran his business, and *New York* magazine calls it, "Luridly detailed." Russell comment: Why all these tell-it-all books? Answer: they're the antidote to the '80s. When there's a lot of dirt hidden under the rug, the revelations are always worth a dozen or so books.

* *

Junk bonds are living up to their name. Last fall the Bond Investor's Association (BIA) estimated that corporate bond defaults would be about $25 billion in 1991 (defaults were $4.6 billion in 1988 and $11.8 billion in 1989). Now the BIA is revising its estimates upward. The new estimate for 1991 is $35 billion to maybe $50 billionin defaults.

* *

Speaking of junk, First Executive insurance company (New York and California) has gone belly up with a portfolio that's a whopping 65% in junk bonds. The collapse puts in doubt thousands of insurance policies with a face value of $38 billion.

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Who Needs Junk Dept? The Portuguese government has come out with a $208 million issue of seven year bonds with a 19.25% coupon. Problem: the Portuguese inflation rate in 1990 was 13%, but it is expected to come down. Now there's an interesting speculation.

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What about the banks? Since 1970 nearly $350 billion in consumers' savings have left the banks for other places (mutual funds, money market accounts, consumer finance and mortgage companies, credit unions, etc.) while $450 billion in corporate borrowing has moved to new credit markets on Wall Street. This has forced the banks to go after other types of risks, and it's been one disaster after another. Among other things, there was a feeding frenzy for foreign loans and another for commercial real estate. So the role of the banks has steadily declined.

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At the end of WWI there were 29,000 banks in the US, many of them small with no branches. From 1931 to 1933 a staggering 9,096 banks failed, wiping out the savings of millions of Americans. Today there are 12,000 banks in the US, but experts are wondering whether we need anything like this many. Japan has only 150 banks, Britain has 550, there are 900 in Germany and only 65 in Canada. No nation has bank failures even remotely comparable to what we've had in America.

* *

The latest figures show that in January the S&Ls lost $9.1 billion in deposits. This was more than the combined withdrawals of the previous two months. It was the 31st month of the last 32nd in which there were net withdrawals. Writes Charlie Allmon of *Growth Stock Outlook*, "We hope the withdrawals continue at an even faster pace . . . and put the industry out of its misery. We do not know of any service provided by the S&Ls which cannot be performed by banks with considerable more safety."

Meanwhile, the Bush proposed bank reforms are scaring depositors at the banks. Small banks in particular are losing depositors' money, and they say this is crimping their ability to make loans.

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The auto picture today: Chrysler has 9.3% of the US market, Ford has 21.1%, GM has 32%. And the Japanese now have 31%. It looks as though the Japanese will have a bigger share than GM within a year. Says an "anguished" Lee Iacocca, a Japanese share of 40% is "within reach." Ironically, Iacocca (who has been specializing in Japan bashing) is now readying a deal with Mitsubishi wherein they will bring heavy financing into Chrysler.

GM, the highest-cost US producer, used up a large part of its financial reserves during 1990. In the nine months ending March 31, GM could take losses of an absolutely incredible $5 billion. (GM is expected to take a loss of $1.8 billion in the first quarter). Furthermore, the GM/UAW labor deal could be reopened, since the company's $4 billion income-security fund is running dry (this is the fund that gives workers 95% of full-time pay if they are laid off).

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The African National Congress called for armed self-defense units to guard the black townships in S. Africa. Mandela called for armed "defense units" regardless of government protests. He said, "If it's OK for whites to have neighborhood watches and civilian guards, it should be equally acceptable for blacks to have their own defense units." Meanwhile, political scientists warn that allowing armed defense units in the townships will take S. Africa a step closer to civil war.

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Sign of the Times: Couture dresses can cost up to $10,000 or even much more. And there's growing resistance. So today many of the top couture houses are now coming out with "secondary lines" that are more affordable for the upper middle class (clothes at $100 to $900). Says Yves Saint Laurent, "There is a change of mentality. Women no longer feel like flying to Paris for fittings and waiting three months for a dress." Says Carolyne Roehm, "Any of us who just stay doing (luxury ready-to-wear) will be dinosaurs."

* *

Germany has its first balance-of-payments deficit in a decade. Its fiscal deficit will be about DM 150 billion. East Germany is proving to be a massive cash drain, and a torrent of marks are being sent to E. Germany in the effort to bring that area into the twentieth century. The huge amount of new marks being created has brought on fears of inflation, something the Germans will not take. So the world looks for higher German interest rates as the Bundesbank contemplates an anti-inflation push. Higher German rates mean pressure on all European currencies and also pressure on the European economies. However, there's one big difference between German deficits and US deficits. With a high savings rate, Germany can finance their whole deficit out of savings. The US can't begin to do the same.

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The *Economist* just presented the latest edition of its famous Big Mac hamburger/currency study. The study prices a Big Mac in various countries, and it compares the prices and adjusts them for purchasing power (in other words, doesn't buy enough) by 61% in the Soviet Union, 48% in Sweden, 34% in Spain, 22% in Belgium, 46% in Denmark, 23% in Italy, 20% in Japan, 29% in France. So those are the countries to avoid it you want to get you dollar's worth. The dollar is overvalued in these countries: 97% in Hong Kong, 43% in Singapore, 47% in Hungary, 17% in Australia, 11% in Canada. Conclusion: go to Hong Kong or Singapore for bargain dollar vacations.

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The latest *Fortune* magazine cover announces, "The Big Split, Japan vs. the US." Subtitle: "It's deeper than ever -- and it's different. Japan is talking back now, and after the Gulf war the US is in little mood to listen." More on this fascinating article in the next Letter.

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The fact is that Japanese competition is the toughest in the world. And it's rubbing the US the wrong way. Here's an interesting insight. The April 13 *Economist* published a special section on consumer electronics. An excerpt: "The Japanese companies have come to dominate the world's consumer-electronics business over the past 20 years partly because others have ignored it, but mostly because there are a dozen of them (Japanese companies) who have fought, and continue to fight, relentlessly at home. None dare relax for a moment. If one manufacturer so much as steals a momentary lead by launching a clever new product, the rest double and triple their efforts so as to have their own version within months. That is the vitality that Japanese companies take with them when they enter markets. And that is the lesson that trade officials everywhere should quietly remember when next they try to 'protect' sleepy local firms from a rude awakening."

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Contravisory Research (37 Derby St, Hingham, Mass. 02043) specialized in long-term relative strength studies. Here are some of their upturns in relative strength for April: Alaska Air Group, Amer. Water Works, Bowater, Brunswick, Fed. Paper Board, Morgan Stanley. Revised downward are Amerada Hess, Boeing, Chem. Waste Management, Deutsche Bank, Mitchell Energy, Murphy Oil.

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The *Economist's* all-items commodity-price index (which excludes fuels) is at a record low in real (inflation adjusted) terms -- almost 50% below its recent 1988 peak. This is one of the oldest indices, first published in 1845. The collapse in commodity prices is partly due to overproduction. In the past year, lead has plunged 35%, zinc 4%, silver 28%, copper 7.5%. The low, low prices are good news for industrialized nations, rotten news for developing countries.

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I've always been a Chinese food nut, so last week Faye and I went to Woh Chee Chon, our local Chinese super market. The variety of exotic foods is mind blowing, and we loaded up with bao, noodles, frozen pot stickers, etc. We also bought a big iron (it's got to be iron) wok. The chinese diet is heavily rice, and we noted maybe 20 kinds of rice for sale, many in big 25 pound bags. The Chinese diet is an excellent one. Ponder this: the average level of blood cholesterol among the Chinese is 137 vs. 212 for Americans. According to researchers, an average Chinese man packs away 300 more calories than an American man, yet the Chinese man weighs 20% less. Chinese women take in half as much calcium (most from plants) as American women, yet they have a lower risk of osteoporosis. The typical Chinese diet includes less than 15% of its calories from fat vs. 37% for Americans. The Chinese eat 35 grams of fiber a day, three times

what Americans eat (it's all those vegetables). Result -- heart attack levels in China much lower than in the US.

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I used to worry a lot about the booming world population, but it looks as if the problem is solving itself in the US -- via murders. In 1990 the US had a record total of 23,220 murders. NYC alone had 2,245 murders, an increase of 17.8% over the previous year. Meanwhile, San Diego is watching a fantastic one-man crime wave, known as "The A's bandit" (so named because he was wearing an Oakland A's baseball hat). This guy has held up 28 banks in San Diego over the past three months. And he's driving our local police nuts. All we know is that he's young, white, calm and wears dark glasses.

* *

The Times: I don't know if this is a comment on the age we live in, but I note the following from a magazine article -- Fernando Lamas was married to Esther Williams who was married to Lex Barker who was married to Lana Turner who was married to Artie Shaw who was married to Ava Gardner who was married to Mickey Rooney who was married to Martha Vickers. Well, at least the marriages were not concurrent.

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For my money, one of the most interesting papers around is the *International Herald Tribune* (owned jointly by the *Washington Post* and the *New York Times*). This paper gives you a truly international view of what's happening, and it is filled daily with excellent columns and news (it has the advantage of *NY Times* correspondents, *Wash. Post* correspondents plus its own correspondents). You can get info at (800) 882-2884, NY call (212) 752-3890. And no, I don't make a cent if you subscribe.

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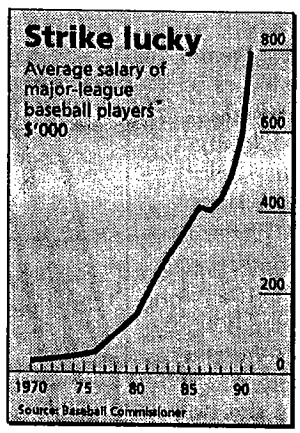
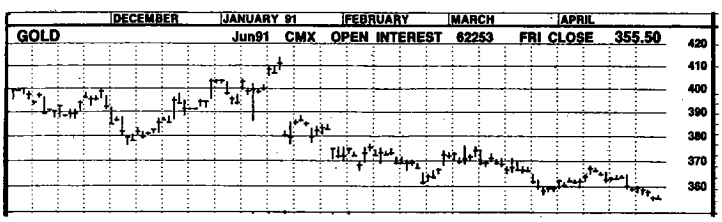
Talk about a parabolic rise, how about this chart of major league baseball player's salaries? Almost all parabolic curves collapse when they reach the vertical stage. What could cause a collapse here? (1) TV broadcasters cutting back on what they're willing to pay ball clubs, (2) The public revolting against rising admission prices, and (3) consequently, clubs going into the red and cutting salaries.



GOLD: This week's rumor is that the beleaguered and besieged and beset Russians are selling large quantities of gold. Why? Because they need hard currency. But why the Russians don't use their brains and make the ruble a hard currency simply by backing it with gold (instead of dumping their gold), I'll never know. Then again, the Russians always seem to behave like idiots where economics are concerned.

The gold chart (courtesy of *Investor's Daily*)shows a well-defined bearish trend for the metal. Support (probably from the central banks) has usually come in around 350. The current very strong dollar is gold's worst enemy.



LATE NOTES, THOUGHTS: In the first quarter the Gross National Product dropped at the rate of 2.8% while inflation rose at the rate of 5.5%. Thus we have two quarters of recession plus inflation, the worst of both worlds.

But the thing that I find most interesting and unusual is the almost universal consensus that the recession will bottom out during the second quarter or maybe in the third quarter. Today there's a persistent, amazingly stubborn optimism in the air. It's an optimism that thrives despite any and all of the negative economic statistics that are now surfacing.

I don't know if this optimism is cyclical, a simple retreat from reality, a result of the ozone breakup, a reaction to the Gulf War or what. My guess is that most of the optimism is based on the stock market's January-to-April advance. And that's rather strange, because during previous recessions when the stock market advanced in the midst of recession, the sentiment has always been that "the market is crazy, the nation is in recession -- has Wall Street taken leave of its senses?" But this time it's widely accepted that Wall Street is absolutely correct, and that it's simply a matter of time before the economy gets in step with the stock market (on the upside, of course).

Maybe it will all work out just as before -- the economy will turn up in June or July, and by yearend the recession will be just another brief chapter in American economic history. Meanwhile, month after month goes by and the great majority of statistics remain negative. So in my mind there's that nagging question -- what if matters don't work out as before?

The world situation is worth watching carefully at this point. In the US, Bush's poll rating declined a bit, while on April 17 auditors announce that the FDIC is nearly insolvent and will need a quick $15 billion. In Germany, Chancellor Helmut Kohl's popularity has suddenly taken a deep plunge, and the German situation looks a lot uglier now than it did six months ago. In Japan, Prime Minister's Kaifu's job suddenly looks shaky. The Soviets continue to teeter on the edge of chaos. The Mideast situation is a mess, if not messier than it was before the war. Canada is suffering a deep recession.

Business is slowing down around the world, and if the US remains in recession and Japan slows down, we could be seeing global recession by yearend. In the face of the global slowdown, there's been a mini-stampede to the dollar. A higher dollar and a downturn in the world economy could play havoc with US exports.

As for our stock market, technically, there's one situation that I'm watching with interest. It's the surprising strength in the D-J Transportation Average. The Dow and the Transports have been moving generally sideways since February, but so far the Transports have been more resistant to decline than the Dow. If this market is to break down technically, the Dow will have to violate its March 21 low of 2855.45 **CONFIRMED** with a Transport violation of its own March 25 low of 1075.20. As I said, so far, the Transports have been very resistant to decline.

Now here's the remarkable thing about the D-J Transportation Average. For the first quarter, nine of the 20 components LOST money. The net result was that the Transportation Average showed earnings of minus $11.76 for the quarter, meaning that the P/E for the Transports is infinity. But still the Transports hold up -- talk about optimism!!

The D-J Utility Average has dropped rapidly, but it is still above major support of 199.63 recorded on January 16. So the **critical numbers** to watch now are Dow **2855.45** and Transports **1075.20.** If this market is in real trouble, a confirming sign will be a violation of those two levels.

Meanwhile, the A-D ratio (see page 2 chart) is just a fraction short of dropping a full point from its high. So any weakness in breadth this week will end the buying stampede. Also note that the Primary Trend Index (PTI) is just above a rising trendline. Weakness this week will cause the PTI to violate this trendline and could put the PTI on a downward path.

NEXT MAILING: May 15